Statement by Ross J. Davidson, Jr.
Administrator
Risk Management Agency
United States Department of Agriculture
Before the House Agriculture Subcommittee on
General Farm Commodities and Risk Management
Wednesday, May 4, 2005

Mr. Chairman and members of the Subcommittee, I am pleased to appear before you today to report on the progress and challenges of the Federal crop insurance program. Under the direction of the Federal Crop Insurance Corporation (FCIC) Board of Directors (Board), the Risk Management Agency (RMA) continues to promote an agenda to bring new and innovative insurance products to the agricultural community, to validate the utility of current insurance products, to ensure outreach to small and limited resource farmers, to promote equity in risk sharing and to guard against waste, fraud and abuse within the program.

This year we mark a major milestone for the crop insurance program. Twenty-five years ago, the Federal Crop Insurance Act of 1980 became law, creating the unique partnership between private insurance companies and the Federal government within the crop insurance program.

The program has experienced extraordinary growth in the last quarter century. Through the private sector delivery system in crop year 2004, RMA provided approximately $46.7 billion of protection to farmers on over 358 commodities covering over 80% of planted acreage in the United States. This coverage was offered through 22 plans of insurance and approximately one and a quarter million policies that insured about 221 million acres. Attached to my testimony are several charts that provide further background and highlight the growth of the Federal crop insurance program.

In 2004, crop insurance provided approximately $3.1 billion in indemnity payments to farmers and ranchers, including approximately $218 million for the four hurricanes in the Southeast and approximately $337 million for upper Midwest freezes.

The roles of crop insurance and the Risk Management Agency have evolved over the years, but our mission remains the same – to promote, support and regulate sound risk management solutions to preserve and strengthen the economic stability of America's agriculture producers. RMA continues to improve and update the terms and conditions of existing crop insurance policies to improve coverage and efficacy of the policies, as well as to clarify and define insurance protection and the duties and responsibilities of the policyholder and approved insurance providers.

The new Standard Reinsurance Agreement (SRA) is now in place, effective for the 2005 crop year. Key changes included a lowering of the percentage rate of Administrative & Operating

(A&O) expense reimbursement, which will be implemented over the 2005 and 2006 reinsurance years. In addition, RMA enhanced the reporting and monitoring of SRA holders with respect to financial solvency. To complement that enhancement, RMA has strengthened formal ties with state insurance regulators and the National Association of Insurance Commissioners (NAIC).

We now have 16 approved insurance providers selling and servicing crop insurance, compared to 14 when the 2005 SRA was signed. Most of these companies have requested authorization to increase the amount of premium they write and the number of states they intend to serve.

Since the SRA was signed, three new insurance companies have been approved. They are Austin Mutual and its Managing General Agent (MGA), Crop USA; the Westfield Insurance Company with its MGA, John Deere Risk Protection, Inc.; and Stonington Insurance Company with its MGA, Agro National LLC.

The 2004 reinsurance year was exceptionally profitable for the companies and their commercial reinsurers, with an estimated $700 million in underwriting gain and a return on retained premium of approximately 22 percent. In 2003, companies had an underwriting gain of $380 million, with a return on retained premium of about 15 percent. In 2002, companies had an underwriting loss of $46 million, with a -2 percent return on retained premium. A&O reimbursement has also risen from $626 million in 2002 to $734 million in 2003, with an estimated $889 million in 2004.

Now I would like to provide an update to the Subcommittee on the following key issues.

RMA Program Issues

- **Premium Reduction Plans**
- **Soybean Rust**
- **Multi-year Disasters/Declining Yields**
- **Misreporting and Penalties**
- **Program Integrity**
- **Conflict of Interest**
- **Pasture, Rangeland, Forage and Hay Initiatives**

Premium Reduction Plans (PRP)

In 1994, Congress added Section 508(e)(3) of the Federal Crop Insurance Act, which allows approved insurance providers to offer reduced premiums to farmers corresponding to demonstrated efficiencies in delivering crop insurance below the A&O expense reimbursement. The Act requires that the efficiency be subject to the rules, limitations and procedures established by the FCIC.

Under the Act, this premium reduction is not considered a rebate. Under a rebate, the insured pays the full premium and a portion of that premium is later returned to the insured. Under a premium reduction plan, the insured receives a discount on his/her premium. In essence, the approved insurance provider is paying an additional premium subsidy on behalf of the producer from savings achieved though efficiencies in the approved insurance provider’s operation.

The Board approved standards for allowing all insurers to be approved to offer PRP in early 2003 in response to the application made by Converium Insurance Companies (Converium) and its Managing General Agency, Crop1. Converium was approved to offer a PRP under those procedures, which were available to all companies. RMA then closely monitored Converium and Crop 1's implementation of their approved PRP, including investigating complaints received from other agents and competing approved insurance providers.

In the few instances that it was found an adjustment was needed, RMA required Converium and Crop1 to adjust their approach in the marketplace to ensure compliance with the rules, limitations and procedures of the crop insurance program in general and those specific PRP procedures established by the Board. This includes the requirement that Converium and Crop1 make insurance available to all farmers in the states in which the company sells and services crop insurance. Farmers who have purchased insurance using the PRP plan expressed appreciation for the lower premiums and consistently reported good service. In addition, Crop1 has a very good record of compliance with the administrative requirements of reporting policy information, remitting payments to FCIC and resolving discrepancies.

A number of additional approved insurance providers have now requested RMA's approval to offer their own PRP. Implementation issues have been raised by these new submissions that were not contemplated when the procedures were drafted. In light of this and other issues that have been raised regarding the effect of PRP on the crop insurance delivery system, the Board adopted a resolution on November 19, 2004 to publish a proposed and final rule to address this issue.

The proposed rule for PRP was published in the Federal Register on February 24, 2005, with a 60-day comment period. The comment period ended on April 25, 2005. RMA has received approximately 600 separate mailings pertaining to the PRP proposed rule. After RMA evaluates and considers all comments received, it will then decide whether any changes need to be made to the proposed rule. The last step in the process will be to publish a final rule, reflecting any changes that may have been made to the proposed rule in response to comments.

Generally, the comments received have expressed concerns about the potential for PRP to reduce agents' commissions and the effect this would have on the agent force and service to producers, particularly small, minority and limited resource producers. Several comments have expressed concerns that PRP will result in larger, lower-risk producers being targeted for the discount, while smaller producers would not be offered the discount. However, RMA has also received comments supporting PRP, stating that Crop1's Premium Discount Plan has allowed producers to purchase higher coverage levels. Briefings on PRP for both the Senate and House Agriculture Committee staffs were also held recently to provide a summary of the comments and answer questions about the process.

The process continues to move along in a timely manner on this issue.

Soybean Rust
Asian soybean rust (*Phakopsora pachyrhizi*) is a fungal disease that can quickly defoliate plants and reduce pod set, pod fill, seed quality and yield.

To ensure that farmers know their rights and responsibilities under the soybean policy, RMA has augmented the information that approved insurance providers are required to provide to farmers through their agents. RMA's communications encourage insured producers concerned about the impact of Asian soybean rust to use good farming practices by seeking and following recommendations of agricultural experts to control soybean rust. Further, RMA recommends that insured producers document the advice received and actions taken to combat this disease and contact their agents on matters related to their insurance policies. Approved insurance providers have been asked to distribute this information to all soybean policyholders.

Additionally, RMA is continually gathering up-to-date information and data regarding the spread and appropriate management of soybean rust. RMA participates in the National Soybean Rust Working Group's bimonthly teleconference and U.S. Department of Agriculture Soybean Rust Working Group. In addition, RMA monitors and participates as necessary in discussions among State and Federal agriculture agencies regarding preventative and control measures. RMA holds a bi-weekly conference call with all RMA Regional Office Directors to discuss their direct contact with local State and Federal agriculture officials to obtain any updated information or developments in the spread and control of the disease.

Multi-year Disasters/Declining Yields
For most FCIC insurance plans, an individual insured's yield guarantee – approved Actual Production History (APH) yield – is principally based on a simple average of four to ten years of actual yields. Producers and others, including you Mr. Chairman, have suggested that insureds are underserved when guarantees decline following successive years of poor growing conditions. The reduction in guarantee can adversely affect the viability of future crop insurance coverage and discourage continued participation in the program.

Multi-year crop losses can create a problem that ought to have a solution and yet, the problem is complex. Last spring, RMA solicited proposals for Alternative Methods for Mitigating Declines in Approved Yields Due to Successive Years of Low Yields. RMA goals were to seek proposals for new or modified approaches to establishing approved APH yields that are 1) less subject to decreases during successive years of low yields as compared to current procedures; 2) equitable across policyholders with differing average yields; 3) broadly applicable to all crops and regions; 4) affordable to policyholders; 5) feasible and cost-effective for RMA and approved insurance providers; and 5) actuarially sound.

Contract proposals have been received and evaluated and RMA recently entered negotiations for two contracts to begin the necessary research and development of alternative methods. The details of those proposals are not publicly releasable at this time, but we will release them as soon as contract negotiations are complete. Any proposal to effectively address this issue will require additional funding and possibly new statutory authority. We appreciate the Subcommittee's continued interest and willingness to assist in addressing this structural challenge to the program.

Misreporting and Penalties

A recently publicized dispute between some Nebraska producers and the Federal crop insurance program highlights the potential problems associated with certifications and correcting multiple years of discrepancies in reported information. The RMA Central Regional Compliance Office is assisting the Office of Inspector General (OIG) in a criminal/civil investigation of a crop insurance agency. The OIG initiated the investigation as a result of RMA reviews that identified the appearance of waste, fraud and abuse in the crop insurance policies serviced by the agency. Currently, the U.S. Attorney's office and OIG are in charge of the matter, with RMA and the impacted insurance providers assisting to bring this matter to a close as soon as possible.

The agency serviced a large book of business of over 400 crop insurance policies in Nebraska and South Dakota. Based on complaints received from the Farm Service Agency (FSA), RMA began investigating the appearance of fraudulent activities of the agency for the 2000, 2001 and 2002 crop years.

RMA found significant misrepresentations of the production and acreages covering several years in crop policies serviced by the agency. The misrepresentations included several cases where producers certified having planted crops they never grew or had not grown in several years and producers certified having an insurable interest in crops in which they had no such interest. There were also instances of inflation or deletion of production histories involving multiple crop units and years, which had the effect of inflating the producers' guarantees. As a result, the producers had inflated APH databases, incorrect insurance premiums and received overpaid indemnities, many occurring over a period of several years.

In November 2002, the approved insurance provider that the agency was affiliated with, American Growers Insurance Company (Growers),was placed under supervision by the State of Nebraska. The policies written by the agency for Growers were then assumed by various companies beginning with the 2003 crop year. By the time OIG released RMA to begin corrective action relative to the incorrect policy certifications, the former agency policies had been placed with 14 different approved insurance providers.

In August of 2004, RMA sent letters to the approved insurance providers notifying them that the RMA reviews had found significant errors in former agency policies and that they needed to have the producers recertify their APH records and make corrections to the 2003 and 2004 data as appropriate. The intent was to provide information to the insurance companies to begin correcting policies, even though the OIG investigation was ongoing.

Some producers who believe the insurance provider's corrections were unfair have filed suit against USDA and RMA. This current legal action is the result of program insurance providers correcting yields that producers could not support with their records. RMA has received enough feedback to recognize that the instructions given in August may need to be revisited to ensure consistent treatment of these producers. Accordingly, RMA has placed a hold on the approved insurance providers implementing those previous instructions so that RMA can clarify the instructions to ensure producers are not adversely impacted because the procedures may have been misunderstood. These producers will be eligible for 2005 crop insurance. However, their coverage may be affected by their ability to prove their yields once the revised guidelines are issued. This in turn may result in corrected premium and indemnities from prior years and may require repayment of amounts to which they were not entitled. Part of the revised procedures will be to provide the specific due process procedures for producers in the event they wish to contest the findings.

Program Integrity

RMA Compliance managers have been concentrating on the mission-critical tasks of evaluating and improving new processes to prevent and deter waste, fraud and abuse in the crop insurance program. Significant effort is dedicated to building and adapting, reporting and tracking feedback systems to complement and integrate the oversight mandates established by the Agricultural Risk Protection Act (ARPA). During 2004, Compliance initiated operation reviews of approved insurance providers to capture a program error rate and to assess approved insurance provider activities under the SRA. The Office of Management and Budget and the USDA Office of Chief Financial Officer are in agreement that a quantifiable program error rate is a key measure in assessing program compliance and integrity.

Additional efforts have been dedicated to integrating data mining projects; exploring avenues to expedite the increase in sanction requests; and continuing to improve the Compliance case management and tracking system. Our Compliance function workload has increased substantially due to the expansion of the Federal crop insurance program and the implementation of ARPA. In order to deal with the increased referral activity, RMA has sought to manage the increase in workload by emphasizing the use of data mining, remote sensing, Geospatial Information technologies and other computer-based resources.

RMA is making significant progress in preempting fraud, waste and abuse through the use of data mining, remote sensing and other advanced technologies. We have preempted millions of dollars' worth of improper payments and RMA continues to identify ways to reduce fraud and provide responsive, useful risk protection to farmers. RMA has used data mining to identify anomalous results in the crop insurance program and, with the assistance of FSA offices, conducts growing season spot checks to ascertain the cause of the results. These spot checks based on data mining have resulted in significant reduction in anomalous claims for certain situations.

RMA saved approximately $125 million in 2002 by deterring or preventing potentially fraudulent claims through data mining and other related activities. Additional savings of approximately $93 million were realized for 2003. We are optimistic about the long-term benefits of data mining in our compliance efforts and elsewhere should Congress continue funding beyond 2005.

A recent activity in this area identified policies where a comparison of past claims and APH data indicated that claim production data was not used to establish the APH as required by procedure. The Compliance Offices have completed their assessment of the accuracy and validation of this information. On October 10, 2004, Compliance notified the approved insurance providers that as a result of data mining, RMA had identified potential debt on approximately 14,000 policy units. The notification also contained a request to hold policy records for these units beyond the three-year record retention requirement, if applicable. Although the request did not immediately require the approved insurance providers to review these policies, several approved insurance providers have initiated reviews to determine the extent of the problem and preclude potentially incorrect payments on crop year 2004 claims. Some of these providers have already notified RMA of certain procedures that account for the discrepancies, confirming the fact that data mining results identify anomalous data, but still require review to determine whether an error exists for the policy.

The return on investment using data mining is significant. For example, RMA believes that over $320 million dollars in estimated savings for the last 4 years is attributable to the data mining spot-check process.   While RMA and FSA have preempted tens of millions of dollars of improper payments through these and other measures, RMA is constantly identifying ways to balance competing needs to make our products fraud proof while seeking to provide responsive, useful risk protection to farmers. We still have work to do and improvements to make, but we are making good progress in our fight against fraud.

Conflict of Interest

RMA has recently issued a Manager's Bulletin and Informational Memorandum containing supplemental guidance to assist approved insurance providers to implement changes to the SRA regarding conflict of interest reporting and prohibited conduct. RMA reiterated the new requirements and issued supplemental guidance to promote program integrity and ensure adequate internal controls, based on the identification of certain problems in past audits and investigations of fraud, waste and abuse in the program. RMA briefed congressional staff on this issue prior to issuing the Bulletin. We appreciate the feedback and assistance in addressing these compliance issues while maintaining the agent's important role in advising policyholders on matters related to their policies.

Pasture, Rangeland, Forage and Hay Initiatives

RMA recently awarded four contracts for research and development of new and potentially innovative crop insurance programs for pasture, rangeland, forage and hay. We are pleased to report that positive progress continues on each of these four contracts. RMA expects that at least one proposal may be ready for the Board to consider for independent expert review as early as July 2005. If approved by the Board, pilot testing could begin in 2006.

Conclusion

RMA continues to evaluate and provide new products and to promote the adoption of crop insurance as a risk management tool so that the government can further reduce the need for ad-hoc disaster payments to the agriculture community

The growth and effectiveness of the crop insurance program is dependent on a reliable delivery system, insurance products that meet the needs of producers, investment in information technology to ensure the delivery system is timely, accurate and dependable, and adequate funding to support compliance and program integrity, product evaluation, maintenance and administration, and new product development.

Again, thank you for the opportunity to participate in this important oversight hearing. I look forward to responding to questions on these issues.